

THE MASSACHUSETTS HEATING OIL INVENTORY PROGRAM

EXECUTIVE SUMMARY

Heating oil inventories provide a critical buffer against interruptions in the supply of heating oil to Massachusetts consumers that might otherwise occur due to weather extremes and transportation problems. In September of 2000, New England heating oil inventories were more than 60% lower than at the same time a year earlier. Market indicators suggested that inventories would not be increased to an appreciable degree before the heart of the winter arrived. Wholesale heating oil distributors were not building inventories. They reported concerns that if they bought oil at high prices at the start of the winter they would be unable to recover those prices later, if wholesale oil prices fell.

In response to these concerns, Massachusetts Governor Argeo Paul Cellucci proposed several legislative actions to address Massachusetts' high heating oil prices and low supplies. This report focuses on one of those actions—the Massachusetts Heating Oil Inventory Program. The goal of the first-in-the-nation program was to reduce the risk of supply interruptions for consumers during the 2000/2001 winter by giving incentives to oil distributors to purchase and store oil in December and hold it until mid-January. On November 9, 2000, the Legislature approved, and Governor Cellucci signed into law, a \$5 million appropriation directing the Division of Energy Resources (DOER) to develop the program.

HIGHLIGHTS

DOER awards contracts to increase Massachusetts heating oil inventories by 32 million gallons.

On November 15, 2000, DOER completed an initial bid selection. Four companies were awarded contracts that required them to buy and store 23.1 million gallons (550,000 barrels) of heating oil (#2 oil) to be held from December 8, 2000 through January 15, 2001. On November 28, 2000, DOER held an additional bidding round for the \$1.7 million in remaining program funds. Five companies, two of which participated in the earlier round, received awards totaling another 8.82 million gallons (210,000 barrels). These awards required program oil be held in storage in Massachusetts from December 22, 2000 through January 15, 2001. The bids produced an average cost of \$0.15 per gallon for oil stored under the program.

As a result of additional program stipulations, the seven winning companies were required to hold a total of 53 million gallons of heating oil in Massachusetts.

In addition to holding in storage in Massachusetts the amount of oil specified in their bids, winning bidders were required to hold in storage an amount of #2 oil that was greater than or equal to the average amount of oil they had in storage in Massachusetts on October 1 – October 5, 2000. DOER considered the October 1- 5 inventory as a baseline inventory for this program. The total amount of oil held in inventory on the October dates by winning bidders at awarded locations was 21,325,794 gallons (507,757 barrels). This amount, together with the two rounds of awards, totaled 53.25 million gallons (approximately 1.3 million barrels) of oil that would be stored in Massachusetts through January 15, 2001.

Program results indicate that actual heating oil volumes held were slightly lower than contract awards.

Compliance monitoring efforts indicated that contractors met the program storage requirements, with two exceptions. In the first instance, a program participant allowed stored volumes to fall below required levels and DOER reduced payment to the company accordingly. Final reconciliation in the second instance was still pending at the time of publication of this report. Program results at this time show that actual program inventory levels were 29.8 million gallons. The recalculated baseline inventory level was 42.3 million gallons. Total program payments will be approximately \$4 million and the final cost per gallon of oil held for the program will be \$0.134.

The total amount of program oil equaled about a 7-day supply for residential customers.

Historically, the amount of heating oil consumed per day in December and in January for Massachusetts' residential customers is roughly 4 million gallons. Therefore, the 29.8 million gallons of oil held as a result of the program would have been sufficient to provide all the oil consumed by residential customers in the state during a seven-day period, if no other oil came into Massachusetts and tanks were completely drawn down. The total amount held—the baseline plus the oil bid for the program—equaled about ten days of supply.

During the program, heating oil inventory levels were higher than expected despite colder weather.

New England had much higher-than-expected inventory levels for both December 2000 and January 2001—the two-month period comprising the program. New England's December and January heating oil inventory levels this winter were 4.7 and 5.6 million barrels, respectively. Based on past inventory level trends and this winter's colder-than-normal weather conditions, DOER's computer simulations showed that December and January inventory levels would have been far less at 2.8 and 1.3 million barrels, respectively. The Massachusetts inventory program was not the only factor behind such an increase in heating oil inventories, but it was an additional factor that was unique to the current heating season.

Wholesale prices in Massachusetts were 2-3 cents per gallon lower than in surrounding states.

Compared to historical prices in neighboring states, wholesale "rack" prices for heating oil in Massachusetts were lower during the program. The 2000/2001 rack prices in Boston, MA averaged \$0.0283 per gallon less than the two-year average in Newington, NH and \$0.0213 per gallon less than the 4-year average. Compared to Providence, RI, Boston prices were \$0.0232 per gallon less over the past two years and \$0.0234 per gallon less than the prior four-year average. Given the amount of heating oil normally purchased during this period of the year (4 million gallons per day) this represents a reduction in price of approximately \$2.7 million to \$3.6 million.

The full report is available at the Division Energy Resources web site, www.state.ma.us/doer, or by calling the Public Information Unit at 617-727-4732.